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IN THE

Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,
Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR *AMICI CURIAE* LAW PROFESSORS IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether a bankruptcy court may approve a contested settlement agreement that distributes assets in violation of the Bankruptcy Code's statutory priority rules and that departs from long-held absolute priority principles underlying the American bankruptcy system.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES v

INTEREST OF *AMICI CURIAE* 1

SUMMARY OF ARGUMENT 1

I. CASE HISTORY 2

A. The Bankruptcy And Settlement Agreement 3

B. The Appeal 6

II. THE CHAPTER 11 SYSTEM 7

ARGUMENT 12

I. THE OPINION BELOW ERRS BECAUSE IT SUBVERTS CONGRESS' POWER TO ESTABLISH BANKRUPTCY'S PAYMENT PRIORITY STRUCTURE 12

A. Congress, Not Courts, Determines Payment Priorities To Advance Bankruptcy Policy 12

B. Settlements In Bankruptcy Are Subject To The "Absolute Priority Rule" 17

II. SUBVERTING BANKRUPTCY'S PRIORITY STRUCTURE WILL CREATE COSTLY UNCERTAINTY 20

A. *Jevic*'s Triggers And Scope Are Uncertain 20

1. Jevic's *Trigger Is Unclear Because This Case Is Not Rare* 21

2. Jevic's *Limits Are Unclear* 23

B. *Jevic*'s Costs 24

CONCLUSION 28

APPENDIX 1a

TABLE OF AUTHORITIES

CASES

Page(s)

Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership, 526 U.S. 434 (1999) 8, 11

Boyer v. Crown Stock Distribution, Inc., 587 F.3d 787 (7th Cir. 2009) 22

Howard Delivery Service, Inc. v. Zurich American Insurance Co., 547 U.S. 651 (2006) 14

Hunter Savings Associates v. Padgett (In re Padgett), 74 B.R. 65 (Bankr. S.D. Ohio 1987) 9

In re Acme Cake Co., 495 B.R. 212 (Bankr. E.D.N.Y. 2010) 21

In re Arnold, 471 B.R. 578 (Bankr. C. D. Cal. 2012) 9

In re Buffet Partners, L.P., No. 14-30699-HDH-11, 2014 WL 3735804 (Bankr. N.D. Tex. July 28, 2014) 14

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TABLE OF AUTHORITIES—Continued

In re Martin, 91 F.3d 38 (3d Cir. 1996) 15
In re Naartjie Custom Kids, Inc., 534 B.R. 416 (Bankr. D. Utah 2015) 14
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LEGISLATIVE MATERIALS

H.R. Rep. No. 95-595 (1977) 20

STATUTES AND RULES

11 U.S.C.
§ 349(b) 12, 19
§ 362(a) 8
§ 363(b)(1) 8
§ 507 ..... 10, 12, 13
§ 507(a)(4) 10

TABLE OF AUTHORITIES—Continued

§ 541(a)(1) 8
§ 726 12
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§ 1104 8
§ 1107(a) 8
§ 1108 8
§ 1112(b)(1) 11
§ 1123(a)(5) 9
§ 1125(a) 10
§ 1125(b) 10
§ 1126(c) 10
§ 1129(a)(7)(A)(ii) 10
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§ 1129(b) 11, 12
§ 1141(d) 9
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INTEREST OF *AMICI CURIAE*[1]

Amici, whose names and affiliations are set forth in alphabetical order on Appendix A, are law professors who study the United States' bankruptcy system. They write solely based on their concern about the effect that the opinion below will have on this system.

SUMMARY OF ARGUMENT

The opinion below threatens the foundation of the bankruptcy system—its priority structure. Congress created a detailed and deliberate order in which creditors should be paid. On the facts of this case, the Bankruptcy Code's priority structure entitled the Petitioners to an estimated $8.3 million dollars for a claim concerning unpaid wages. Instead, a divided panel of the Third Circuit approved a settlement agreement and dismissal order (known collectively as a "structured dismissal")[2] that expressly disregarded the Petitioners' priority entitlement and, despite properly lodged objections, awarded them nothing. By distributing the debtor's estate to junior creditors rather than paying wage claims with uncontested priority, the Third Circuit's opinion flouted the Bankruptcy Code's priority rules and longstand-

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[1] The parties have consented to the filing of this brief in blanket letters on file with the Clerk. No counsel for a party authored this brief in whole or in part, and no persons or entities other than *amici* and their counsel made a monetary contribution to the preparation or submission of this brief.

[2] *See generally* Christopher W. Frost, *Structured Dismissals: Smooth Off-Ramp or Artful Dodge?*, 35 Bankr. L. Letter 10 (2015) (describing structured dismissals).

ing norms. Nothing in the Bankruptcy Code—not a liquidation under Chapter 7 or a reorganization plan under Chapter 11—permits this kind of priority-skipping settlement in the absence of creditor consent.

The Third Circuit's majority held that deviating from the Bankruptcy Code's priority rules was justified because "rare" cases require this sort of "flexibility." Pet. App. 2a, 12a & 18a. There is, however, no workable standard for determining what makes this case "rare," and, as Judge Scirica's dissenting opinion observed, there is correspondingly little guidance on what should trigger deviations in future cases—or how far such deviations may go.

By creating an end run around the Bankruptcy Code's explicit priority rules, the Third Circuit's approach fosters perverse incentives: powerful parties will increasingly seek to resolve corporate bankruptcy cases through structured dismissals which lack creditor safeguards that Congress built into the bankruptcy process. The decision below will increase the costs of resolving Chapter 11 cases without any corresponding benefits, while also undermining core fairness goals in the Chapter 11 bankruptcy system.

I. CASE HISTORY

Jevic Transportation, Inc. ("Jevic," or the "Debtor") was a New Jersey trucking company. Pet. App. 2a.[3] A subsidiary of Respondent Sun Capital Part-

[3] Appendix citations refer to the appendices in the Petitioners' certiorari petition ("Petition") or in the joint appendix (JA) filed by the parties at the merits stage.

ners,[4] a private equity firm, acquired Jevic in a leveraged buyout (LBO) in 2006.[5] *Id.* After the LBO, Jevic refinanced its debt with CIT Group ("CIT"), which lent Jevic $85 million in revolving credit secured by Jevic's assets. JA22.

A. The Bankruptcy And Settlement Agreement

Jevic could not service this debt. It filed a Chapter 11 bankruptcy on May 20, 2008, one day after terminating 90% of its employees, including Petitioners, Jevic's truck drivers (the "Drivers"). JA161.[6]

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[4] This brief refers to Sun Capital Partners and its affiliated entities as "Sun."

[5] In a leveraged buyout, a purchaser such as Sun will acquire the stock of a target company, such as the Debtor.

> The acquirer finances the acquisition by borrowing a significant portion of the purchase price, liability which it causes [Debtor (D)] to assume after closing, secured by D's assets. The (borrowed) purchase price is then remitted to D's pre-acquisition shareholders. This has the effect of giving D's selling shareholders the benefit of using D's assets to gain priority over D's pre-bankruptcy unsecured creditors, who will be junior in right to LBO lenders with liens encumbering D's assets.

Jonathan C. Lipson & Jennifer Vandermeuse, Stern, *Seriously: The Article I Judicial Power, Fraudulent Transfers, and Leveraged Buyouts*, 2013 Wis. L. Rev. 1161, 1220.

[6] *See also Joint Motion of the Debtors, CIT, Sun Capital and the Official Committee of Unsecured Creditors Pursuant to 11 U.S.C. §§ 105(a), 349 and 1112(b) and Fed. R. Bankr. P. 9019 for Entry of an Order: (I) Approving Settlement Agreement and Releasing Claims; (II) Dismissing the Debtors' Cases Upon Implementation of Settlement; and (III) Granting Related Relief* at 2, ¶ 1 ("Settlement Motion").

Petitioners hold an estimated $8.3 million in priority wage claims against Jevic for violating New Jersey's version of the federal Worker Adjustment and Retraining Notification ("WARN") Act, which requires notification before mass layoffs. *See* CAJA1087–99 (complaint), CAJA1137–38 (class certification); 29 U.S.C. §§ 2101–2109; N.J. Stat. Ann. §§ 34:21-1 to -7.

The Official Committee of Unsecured Creditors ("Committee") was given permission to sue Sun and CIT on behalf of the bankruptcy estate, alleging that the LBO transfers were avoidable fraudulent and preferential transfers (the "Adversary Proceeding").[7] Pet. App. 3a. Sun and CIT moved to dismiss the Adversary Proceeding. The Bankruptcy Court denied the motion to dismiss, concluding that the Committee adequately pleaded such claims. JA36–47. If the Adversary Proceeding succeeded, the estate could avoid liens and potentially recover more than $100 million from Sun and CIT. JA54–56.

Jevic borrowed more from CIT during its case on a "super-priority," secured basis. Settlement Motion 3–4, ¶ 8. This left Jevic "administratively insolvent," meaning that its operating expenses in bankruptcy exceeded the value of its unencumbered assets. Pet. 5–6, 10.

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[7] Leveraged buyouts may be avoided as fraudulent transfers if the transfers (*e.g.*, lenders' liens or payments to selling shareholders) were made for less than reasonably equivalent value while the debtor was insolvent. If the debtor was (or was rendered) insolvent and "receives nothing but debt in the LBO, it is not difficult to establish that it received inadequate value," thus establishing a *prima facie* case to avoid the LBO transfers. Lipson & Vandermeuse, *supra* n.5, at 1220.

All major parties—except the Drivers—entered into an agreement (the "Settlement Agreement") settling the claims in the Adversary Proceeding. Pet. App. 4a. The Settlement Agreement had two main elements relevant to this dispute:

- *First*, Sun and CIT would pay about $3.7 million to satisfy certain administrative expenses, such as fees of the Committee's counsel, with the remainder going to general unsecured creditors—failing to pay the priority claims of the Drivers. Pet. 11.
- *Second*, Sun and CIT would be released from any liability associated with the LBO, including the fraudulent transfer claims asserted in the Adversary Proceeding.[8]

The Drivers objected. On December 4, 2012, the Bankruptcy Court entered an order, over the Drivers' objection, approving the Settlement Agreement (the

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[8] Specifically, the Settlement Agreement releases CIT and Sun from—

> any and all claims or counterclaims, causes of action, remedies, damages, liabilities, debts, suits, demands, actions, costs, expenses, fees, controversies, set-offs, *third party actions or proceedings relating in any way to, or arising from any transaction with or in connection to, the Debtors or their estates of whatever kind or nature* including, without limitation, *any and all claims asserted in or which could have been asserted in, or which related to the subject matter of the Adversary Proceeding*, or which are based on any avoidance or other powers afforded the Estate Releasing Parties under the Bankruptcy Code "

Settlement Agreement ¶ 2(c)(i), (ii), at 4–6 (emphasis supplied) (exhibit A to the Settlement Motion).

"Dismissal Order" and, together with the Settlement Agreement, the "Structured Dismissal"). Pet. App. 45a. The Bankruptcy Judge's reasoning included a factual finding that the estate was administratively insolvent and thus could not remain in bankruptcy. But the Dismissal Order also included the legal conclusion that the Bankruptcy Code's priority rules did not apply to a settlement, as distinct from a Chapter 11 plan or Chapter 7 liquidation. *Id.* 58a.

The Bankruptcy Judge rejected the suggestion that the case should be converted to a Chapter 7 liquidation, where the priority rules would undoubtedly apply, because the lenders made clear that they would refuse to reach the same settlement if the case were converted, and "it does not appear that a Chapter 7 Trustee would have any money to operate, investigate or litigate." *Id.* Yet, the fraudulent transfer claims asserted in the Adversary Proceeding were at least strong enough to survive motions to dismiss. *See In re Jevic Holding Corp.*, No. 08-11006 BLS, 2011 WL 4345204, at *10–12 (Bankr. D. Del. Sept. 15, 2011); *see also* Pet. 10. As noted above, if the Adversary Proceeding succeeded, the estate could potentially recover more than $100 million.

B. The Appeal

The Drivers appealed. The District Court and a divided Third Circuit Court of Appeals affirmed the Bankruptcy Court.

The majority below concurred with the reasoning of the Bankruptcy Judge that the Bankruptcy Code's priority rules did not apply to the distribution of estate assets under a settlement agreement. Pet. App. 17a. In "rare instances," the majority reasoned, a

court may skip priority claims when distributing estate assets if the bankruptcy court has "specific and credible grounds to justify [the] deviation." *Id.* 12a, 21a (alteration in original; internal quotations omitted). The majority found such grounds here, endorsing the Bankruptcy Court's conclusion that the settlement and structured dismissal were the "least bad alternative." *Id.* 21a-22a.

Judge Scirica dissented. In his view, "the bankruptcy court's order undermined the [Bankruptcy] Code's essential priority scheme" by "skip[ping] over an entire class of creditors" in distributing estate property. *Id.* 23a, 29a-30a. While he left open the possibility that in "extraordinary circumstances" the Bankruptcy Code might permit a settlement that deviates from the priority scheme, he found that the Structured Dismissal here was "an impermissible end run around the carefully designed routes by which a debtor may emerge from Chapter 11 proceedings." *Id.* 24a, 27a-28a. Judge Scirica also warned that, contrary to the majority's assertion, the circumstances here were not "sui generis" and that it is "not difficult to imagine another secured creditor who wants to avoid providing funds to priority unsecured creditors." *Id.* 31a.

The Petition followed.

II. THE CHAPTER 11 SYSTEM

Chapter 11 of the Bankruptcy Code is the principal legal mechanism for restructuring troubled business organizations. Commencing a Chapter 11 case has three simultaneous legal consequences:

- *First*, an "estate" is created, comprised of all property of the debtor. 11 U.S.C. § 541(a)(1). The estate includes hard assets as well as intangible assets, such as causes of action.
- *Second*, a fiduciary manages the debtor's estate. Chapter 11 presumes that the debtor's management team will serve this role as the "debtor in possession" (DIP) unless the court orders otherwise. 11 U.S.C. §§ 1101(1), 1104. As fiduciaries, the DIP has a duty to act in the best interest of the bankruptcy estate. 11 U.S.C. § 1107(a). The DIP may operate the debtor in the ordinary course. 11 U.S.C. §§ 363(b)(1), 1108.
- *Third*, a stay of collection actions goes into effect. 11 U.S.C. § 362(a). This "automatic stay" is meant to create an opportunity for the DIP and creditors to determine the best way to maximize the value of the debtor, including restructuring or sale.

Bargaining and negotiation are central features of Chapter 11. "'[T]he Chapter 11 process,'" this Court has explained, "'relies on creditors and equity holders to engage in negotiations toward resolution of their interests. *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 457 n.28 (1999) (quoting Eric G. Brunstad, Jr., Mike Sigal, & William H. Schorling, *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part One*, 53 Bus. Law. 1381, 1406 n.136 (1998)). A Chapter 11 case is often characterized as "an invitation to a negotiation" between the debtor and its stakeholders.

See In re Arnold, 471 B.R. 578, 592 (Bankr. C.D. Cal. 2012) (quoting Elizabeth Warren & Jay Lawrence Westbrook, *The Law of Debtors and Creditors* 397 (6th ed. 2009)). These negotiations are meant to channel participants toward a "plan of reorganization," a complex instrument that "represents a kind of consent decree which has many attributes of a contract." *See In re Stratford of Texas, Inc.*, 635 F.2d 365, 368 (5th Cir. 1981).

Although reorganization of the debtor was traditionally the goal of Chapter 11, the Bankruptcy Code expressly contemplates that the plan process can be used to effectuate a sale of assets, whether as a going concern or piecemeal. 11 U.S.C. § 1123(a)(5). Plans can be used even when (as in *Jevic*) a debtor has gone out of business, because they provide a fair and efficient means for liquidating and distributing the value of the debtor's estate. *See, e.g., Hunter Savings Assocs. v. Padgett (In re Padgett)*, 74 B.R. 65, 67 (Bankr. S.D. Ohio 1987) (characterizing liquidating plans as an "effective reorganization.").

Plans can have a wide range of effects. Among other things, they will generally pay creditors a portion of their claims and discharge—eliminate legal liability for—the balance. 11 U.S.C. §§ 1123(a)(5) & 1141(d).

The Bankruptcy Code contains procedural and substantive protections that must be met to confirm a plan, four of which stand out in this case:

- *First*, the plan must have been presented to creditors in a "disclosure statement" which contains "adequate information" about the plan and the debtor sufficient to enable credi-

tors to vote for or against it. 11 U.S.C. § 1125(b).[9] When cases are resolved via structured dismissal, as in *Jevic*, creditors receive no disclosure statement.

- *Second*, the plan must have a minimum level of stakeholder support, generally speaking the vote of 2/3 in dollar amount and more than half in number of creditors. 11 U.S.C. § 1126(c). Having this requisite level of creditor support is an essential precondition to binding holdouts and objectors to a plan. In *Jevic*, creditors had no vote.

- *Third*, the plan must pay each creditor no less than such creditor would receive in a Chapter 7 liquidation. 11 U.S.C. § 1129(a)(7)(A)(ii). In a Chapter 7 liquidation, the trustee would have had to pay the Drivers in full before paying lower priority creditors. This is because a Chapter 7 distribution must strictly follow the priority rules in section 507 of the Bankruptcy Code. Section 507(a)(4) provides that unpaid wage claims, such as the Drivers', must be paid fourth in order of priority from assets of the debtor's estate. 11 U.S.C. § 507(a)(4). Thus, section 507 bars final distributions to junior claimants unless priority creditors either are paid in full in cash or agree otherwise. 11

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[9] "Adequate information" is defined as "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records that would enable [] a hypothetical investor of the relevant class to make an informed judgment about the plan." 11 U.S.C. § 1125(a).

U.S.C. § 1129(a)(9)(B). The Drivers received nothing on account of their priority claims, and did not agree otherwise, while general unsecured creditors received about $1.7 million from Jevic's estate.

- *Fourth*, a dissenting class of creditors cannot be bound by a Chapter 11 plan unless the court makes additional findings about their treatment. Specifically, to approve a plan over the objections of a dissenting class, the court must find, among other things, that the plan is "fair and equitable." 11 U.S.C. § 1129(b). "Fair and equitable" is a term of art which implements the so-called "absolute priority rule" (APR). "[T]he absolute priority rule . . . require[s] that 'the creditors . . be paid before the stockholders could retain [equity interests] for any purpose whatever.'" *LaSalle*, 526 U.S. at 444 (internal citations omitted). The absolute priority rule is the "cornerstone of reorganization practice and theory." *See* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 123 (1991). Here, there was no plan and no such analysis to protect the Drivers.

If plan negotiations fail, or the debtor's reorganization otherwise appears hopeless, the case may be converted to a liquidation under Chapter 7 of the Bankruptcy Code or dismissed. 11 U.S.C. § 1112(b)(1). In the event of conversion to Chapter 7, the debtor's assets will be liquidated by a trustee. If the case is dismissed, the Bankruptcy Code generally contemplates that the debtor and its stakeholders

are to be returned to the pre-bankruptcy status quo. 11 U.S.C. § 349(b).

ARGUMENT

I. THE OPINION BELOW ERRS BECAUSE IT SUBVERTS CONGRESS' POWER TO ESTABLISH BANKRUPTCY'S PAYMENT PRIORITY STRUCTURE

The majority opinion below concludes that, at least in some instances, a settlement agreement and dismissal order need not comply with the rules just reviewed. That conclusion conflicts with the Bankruptcy Code and longstanding, core bankruptcy principles.

A. Congress, Not Courts, Determines Payment Priorities To Advance Bankruptcy Policy

As noted, above, bankruptcy uses two sets of priority rules: (i) those created by Congress, in § 507 of the Bankruptcy Code, and (ii) the "absolute priority rule" used, among other things, to assess plans (11 U.S.C. § 1129(b)) and settlements.[10] Those rules apply in the only two ways that final distributions may be made in a bankruptcy case: (i) a confirmed Chapter 11 plan, or (ii) a Chapter 7 liquidation.[11] Unless a party with a priority entitlement agrees otherwise, there is simply no basis for deviating from the Bank-

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[10] As discussed below, the absolute priority rule applies to settlements as a matter of common law, not statute. *See Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 432 (1968).

[11] 11 U.S.C. § 726.

ruptcy Code's priority structure when making final distributions.[12]

The statutory priority rules set out in section 507—including the uncontested priority of the Drivers' claims in *Jevic*—reflect explicit legislative judgments. "Code-authorized priorities among unsecured claims are rooted both in the exigencies of bankruptcy, and in other public policy considerations." Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 Yale L.J. 862, 906 (2014). These political judgments made by Congress, in turn, reflect democratic decision-making about the resolution of financial distress. Priority treatment for claims of rank-and-file workers—the very category of claim that the Structured Dismissal in *Jevic* intentionally excluded—is a key example of Congress deliberately protecting a class of claimants that otherwise might have little leverage in a Chapter 11 case.

This Court recently—and unanimously—reminded us of the importance of honoring Congress' judgments of this sort even if, under the facts of some cases, the outcome is perceived as undesirable or inconvenient. In the context of property exemptions for individual debtors, this Court observed that: "The Code's meticulous—not to say mind-numbingly

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[12] We focus here on final distributions of estate property. Courts and scholars debate the circumstances under which the bankruptcy estate can make *interim* distributions to creditors in the absence of statutory authority, if doing so maximizes the bankruptcy estate overall. *See, e.g., In re Kmart Corp.*, 359 F.3d 866, 868 (7th Cir. 2004). That issue need not be resolved to determine that the distribution of assets in *Jevic* was impermissible.

detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions." *Law v. Siegel*, 134 S. Ct. 1188, 1196 (2014).

"To give priority to a claimant not clearly entitled thereto," this Court said in *Howard Delivery Services*, "is not only inconsistent with the policy of equality of distribution; it dilutes the value of the priority for those creditors Congress intended to prefer." *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 667 (2006) (internal quotations and citation omitted). By giving the Drivers' priority entitlement to junior unsecured creditors instead, that is what the Settlement Agreement did. Yet, it is not the province of courts to displace Congressionally-established priorities, as happened in this case.

Neither Respondents (to date) nor the lower court majority have cited any published or unpublished decisions in which priority was altered in a final distribution of estate property over the objection of a priority creditor, and we are aware of none.[13] This may be because the Bankruptcy Code's priority structure is clear, and courts recognize that

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[13] Indeed, structured dismissal cases on which the majority rely, such as *Buffet Partners*, were careful to point out the absence of objections to the dismissal there. *See In re Buffet Partners, L.P.*, No. 14-30699-HDH-11, 2014 WL 3735804, at *3 (Bankr. N.D. Tex. July 28, 2014) (approving structured dismissal where "[t]here are no non-consenting creditors [and] [t]he proposed structured dismissal appears fair and equitable."), *cited in* Pet. App. 15a; *see also In re Naartjie Custom Kids, Inc.*, 534 B.R. 416, 426 (Bankr. D. Utah 2015) (approving structured dismissal because, among other things, "no economic stakeholder has objected").

they are not at liberty to subvert Congress' policy judgments in this regard.

Respondents and the lower court appear to recognize that the Structured Dismissal here advances no *bankruptcy* policy. Indeed, as Judge Scirica noted in dissent, "it is difficult to see how the settlement is directed at estate-value maximization. The settlement deviates from the [Bankruptcy] Code's priority scheme so as to maximize the recovery that certain creditors receive." Pet. App. 26a (Scirica, J., concurring in part and dissenting in part). Instead, the Respondents and lower court have posited more generally that "'settlements are favored in bankruptcy.'" Resp. Opp. 19.[14]

This truism cannot solve the problem with *Jevic*. This Court has previously condemned the prospect of two parties stripping the rights of a third party under the guise of a settlement. "[P]arties who choose to resolve litigation through settlement," this Court has stated, "may not dispose of the claims of a third party, and *a fortiori* may not impose duties or obligations on a third party, without that party's agreement." *Local No. 93, Int'l Ass'n of Firefighters, AFL-CIO C.L.C. v. City of Cleveland*, 478 U.S. 501, 529

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[14] Bankruptcy settlements in the Third Circuit are governed by the four-part test articulated in *In re Martin*. 91 F.3d 389, 393 (3d Cir. 1996) (Courts should assess "(1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors."). As the Third Circuit has noted elsewhere, the purpose of the *Martin* test is "to maximize the recovery of those to whom the company has obligations." *In re RFE Indus., Inc.*, 283 F.3d 159, 165 (3d Cir. 2002).

(1986). That, however, is exactly the effect of *Jevic*'s Structured Dismissal: it takes the Drivers' entitlement to recoveries on their undisputed priority claim—which the Drivers estimate to be over $8 million—and distributes it, instead, to junior unsecured creditors.

It is no answer to say that Respondents would not settle on other terms, and thus the Drivers' statutory priority rights must be ignored.[15] As Judge Scirica correctly observed in his dissent, it was "[c]ritical to th[e] analysis . . . that the money paid by the secured creditors in the settlement was property of the estate." Pet. App. 28a. (Scirica, J. dissenting in part and concurring in part). While Respondents could have walked away, they would have faced the risk of continued litigation over the failed LBO. Having chosen to purchase peace, instead, they had no power to direct the distribution of proceeds received by the estate in derogation of the Bankruptcy Code's priority rules.

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[15] Sun's expressed reason for refusing to settle with the Drivers is especially ironic. Its counsel argued that payment to the Drivers would have amounted to funding an adversary's litigation. Pet. App. 24a ("As Sun's counsel explained at the settlement hearing, 'if the money goes to the WARN plaintiffs, then you're funding someone who is suing you who otherwise doesn't have funds and is doing it on a contingent fee basis.'") (Scirica, J. dissenting in part and concurring in part). Yet, even without being paid on account of their priority claim, the Drivers pursued the WARN Act litigation against Sun—which was not settled in the Settlement Agreement—and Sun won. *See In re Jevic Holding Corp.*, No. 14-4331, 2016 WL 4011149, at *1 (3d Cir. July 27, 2016).

B. Settlements In Bankruptcy Are Subject To The "Absolute Priority Rule"

Respondents have argued that "[t]here is not a single reported decision from any circuit holding that any provision of the Bankruptcy Code extends the absolute priority rule to settlements." Resp. Opp. 12. Respondents are wrong.

Respondents and the majority below rely heavily on the Second Circuit's decision in *In re Iridium Operating LLC*, 478 F.3d 452, 463–64 (2d Cir. 2007). Pet. App. 19a ("We agree with the Second Circuit's approach in *Iridium*."); Resp. Opp. 2 (citing *Iridium*, 478 F.3d at 455). The reliance is misplaced.

In *Iridium*, the unsecured creditors' committee sought to settle a suit it had brought against a group of secured lenders that would have divided the estate's cash between the lenders and a litigation trust created to sue Motorola, a priority administrative creditor (and the debtor's corporate parent). 478 F.3d at 456, 459–60. Motorola objected to the settlement, arguing that the distribution violated the absolute priority rule by skipping its first-priority claim. *Id.* at 456.

The Second Circuit looked to this Court's opinion in *TMT Trailer Ferry v. Anderson*, which "held that '[t]he requirements that plans of reorganization be both 'fair and equitable' apply to compromises just as to other aspects of reorganizations.'" *See Iridium*, 478 F.3d at 463 (quoting *Protective Comm. for Indep. Stockholders*, 390 U.S. at 424).

Consistent with *TMT Trailer Ferry*, the Second Circuit did not approve the priority-skipping distribution sought in *Iridium*. Rather, it remanded with

the observation that whether a settlement "complies with the Bankruptcy Code's priority scheme *will be the most important factor* for a bankruptcy court to consider in approving a settlement." *See Iridium*, 478 F.3d at 455 (emphasis supplied).

Iridium provides no support for the Structured Dismissal here, for two reasons. *First*, the majority below strayed far from the language of *Iridium*. Respecting the priority claims of the Drivers was hardly the "most important factor" in approving the Structured Dismissal.

Second, no court in *Iridium* ultimately blessed a priority-skipping settlement. Rather, on remand, it appears that Motorola, the debtors, and other creditors continued to negotiate. Their disputes were resolved in a "Global Settlement" under which priority-creditor Motorola apparently released its administrative expense claims and consented to distributions to (junior) unsecured creditors. *See Order Approving a Global Settlement of Disputes Between and/or Among the Debtors, The Statutory Creditors' Committee, the Debtors' Prepetition Secured Lenders and Motorola, Inc.* (Dkt. No. 1540), *In re Iridium Operating LLC*, No. 99-45005 (JMP) (Bankr. S.D.N.Y. May 20, 2008). Thus, it appears no priority-skipping distribution was made over the objection of a non-consenting priority creditor.

What ultimately happened in *Iridium* is what should have happened in *Jevic*. Rather than approve the Structured Dismissal over the Drivers' objection, the court below should have sent it back to the Bankruptcy Court for further proceedings. Consistent with the bargaining dynamic that is central

to bankruptcy, it is likely (although not guaranteed) that the parties here would have negotiated to revise the Settlement Agreement which, if acceptable to all parties, would have resolved their disputes, and paved the way for a resolution of this case consistent with the Bankruptcy Code's priority system.

Unfortunately, the *Jevic* majority failed to appreciate the bargaining dynamic at work in *Iridium*. While bankruptcy, like other fields of law, seeks to promote settlement, the desire to settle is not license to violate the law over the objection of a party harmed by the violation.

Here, the Structured Dismissal released Sun and CIT from liability—inside bankruptcy and out—for the failed leveraged buyout that led to the company's bankruptcy. It therefore not only skipped the Drivers' priority claim; it also foreclosed their only remaining source of recovery. But for Jevic's bankruptcy, the Drivers would have been able to assert in state court fraudulent transfer claims similar to those in the Adversary Proceeding, because every state has a law permitting avoidance of fraudulent transfers. *See, e.g.*, N.J. Stat. Ann. § 25:2-20 (2015) (New Jersey's version of Uniform Fraudulent Transfer Act). Absent the releases, the dismissal of the bankruptcy would have revested those claims with non-settling creditors, here the Drivers.[16]

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[16] Section 349 of the Bankruptcy Code governs the effect of dismissals. It provides, in pertinent part, that "[u]nless the court, for cause, orders otherwise, a dismissal of a case (3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title." 11 U.S.C. § 349(b). This means that dismissal should "undo the bankruptcy case, as far as practica-

II. SUBVERTING BANKRUPTCY'S PRIORITY STRUCTURE WILL CREATE COSTLY UNCERTAINTY

The opinion below creates uncertainty about the conditions that would permit its deviations, and how far such deviations may go. This uncertainty imposes steep costs.

A. *Jevic*'s Triggers And Scope Are Uncertain

The *Jevic* majority justified deviating from the Bankruptcy Code's priority and dismissal rules due to the "dire circumstances" of the case. Pet. App. 8a. Thus, the Third Circuit majority concluded that priority-skipping settlements may be approved "in a rare case," if the bankruptcy court has "'specific and credible grounds to justify [the] deviation.'" *Id.* 21a (quoting *Iridium*, 478 F.3d at 466) (alteration in original). Unfortunately, as Judge Scirica observed, the majority opinion offers no guidance on what makes this case "rare."[17]

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ble." H.R. Rep. No. 95-595, at 338 (1977). In this case, the Structured Dismissal and Settlement Agreement released Sun and CIT from "*third party actions or proceedings relating in any way to, or arising from any transaction with or in connection to, the Debtors or their estates of whatever kind or nature* ... including, without limitation, *any and all claims asserted in or which could have been asserted in, or which related to the subject matter of the Adversary Proceeding* ." Settlement Agreement ¶ 2(c)(i), (ii), at 4–6 (emphasis supplied). In so doing, the *Jevic* majority significantly expanded the "cause" exception in § 349. *Cf. In re Sadler*, 935 F.2d 918, 921 (7th Cir. 1991) (reversing lower courts' approval of a dismissal order that stripped a secured creditor of its collateral).

[17] "I depart from the majority opinion," he explained "in holding this appeal presents an extraordinary case where de-

1. Jevic's Trigger Is Unclear Because This Case is Not Rare

The key factor appears to have been the estate's administrative insolvency. *See* JA180; Pet. App. 58a. Administrative insolvency means that a debtor is unable to pay the ongoing expenses of operating in bankruptcy. That may be grounds to convert or dismiss a case. *See, e.g., In re Acme Cake Co.*, 495 B.R. 212, 217 (Bankr. E.D.N.Y. 2010). Administrative insolvency does not, however, make a case "rare." *See* American Bankruptcy Institute, Commission to Study the Reform of Chapter 11, *2012-2014 Final Report and Recommendations* 173 (2014) (noting that "'administratively insolvent' cases have become more common"). Nor does it justify deviation from the Bankruptcy Code's priority rules.

Conditioning priority rule deviations on the debtor's financial condition arguably creates perverse incentives to impair a debtor's solvency, further undercutting Congress' authority in creating the priority structure. Indeed, *Jevic* would seem to reward those who contribute to administrative insolvency through pre- and post-bankruptcy lending transactions while they also seek to dictate the terms of a final distribution that defies the bankruptcy priority rules.

At bottom, this case was a garden-variety failed leveraged buyout (LBO). Failed-LBO bankruptcies are hardly rare.[18] They often result in fraudulent

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parture from the general rule is warranted." Pet. App. 24a (Scirica, J. dissenting in part and concurring in part).

[18] The recent bankruptcies of Caesar's Entertainment and Energy Future Holdings Corp., for example, were precipitated

transfer suits, as happened here. *See, e.g.*, *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787 (7th Cir. 2009); *In re Lyondell Chem. Co.*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014); *In re Tribune Co. Fraudulent Conveyance Litigation*, 499 B.R. 310 (S.D.N.Y. 2013); *see also* Martin D. Ginsburg, Jack S. Levin & Donald E. Rocap, *Mergers, Acquisitions and Buyouts* ¶ 1706 (Wolters Kluwer, Sept. 2015) (collecting LBO/fraudulent transfer cases).

Neither the Third Circuit majority opinion nor the underlying facts reveal what makes *Jevic* rare. Because its facts are not rare, the decision is simply not clear as to what should trigger similar deviations in the future. This uncertainty "would seem to invite further litigation to test [*Jevic*'s] boundaries." *See* Jonathan C. Lipson & Stephen Walsh, *In re Jevic Holding Corp.*, 3, ABA Business Bankr. Committee Newsl. (American Bar Association, Chicago, Ill.), May 21, 2015, http://apps.americanbar.org/buslaw/committees/CL160000pub/newsletter/201507/fa_3.pdf. This state of affairs may be attractive to repeat players in Chapter 11 cases who would prefer a distribution of estate assets other than the one the Bankruptcy Code requires.

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by failed leveraged buyouts. *See* Jim Christie, *Caesars Invites Bankruptcy Examiner to Probe Leveraged Buyout*, Reuters, July 2, 2015, http://www.reuters.com/article/bankruptcy-caesars-idUSL1N0ZI0FB20150702#EQIcL2jYOSClJILY.97; Matt Levine, *Largest Leveraged Buyout Ever Is Finally Bankrupt*, Bloombergview, Apr. 29, 2014, http://www.bloombergview.com/articles/2014-04-29/largest-leveraged-buyout-ever-is-finally-bankrupt (discussing Energy Future Holdings).

2. *Jevic's Limits Are Unclear*

As *Jevic's* trigger is uncertain, so too is its stopping point. If a settlement can skip the Drivers' statutory priority, other equally foundational priority rules and standards may be up for grabs, too.

Consider, for example, the classic application of the absolute priority rule, to prevent the "squeeze out" of unsecured creditors in a reorganization plan.[19] Absolute priority developed in response to railroad reorganizations in which senior creditors and junior shareholders were sometimes said to collude in an effort to retain control of a distressed debtor, skipping over intermediate creditors. Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 Cornell L. Rev. 1420, 1445 (2004) (calling this dynamic "[o]ne of the most controversial features of receiverships").

Absolute priority became "the familiar rule that the stockholder's interest in the [debtor's] property is subordinate to the rights of creditors . . . first, of secured, and then of unsecured, creditors." *See Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.*, 174 U.S. 674, 684 (1899). "'Any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation,'" this Court has said. *See N. Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 505 (1913) (quoting *Louisville Trust*, 174 U.S. at 684). If *Jevic* permits the squeeze-out of the Drivers in a set-

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[19] The Bankruptcy Code's current use of the absolute priority rule in connection with Chapter 11 plans is discussed above.

tlement and dismissal order, it is not clear why a settlement and dismissal order could not also eliminate the rights of general unsecured creditors using a similar rationale.

Likewise, *Jevic* raises questions about statutes that confer priority outside of the bankruptcy system. Under a federal statute designed to protect government claims, for example, "a claim of the United States Government shall be paid first when a person indebted to the Government is insolvent" and, intentionally or not, the debtor's assets are placed beyond the reach of the federal government.[20] If federal courts can deprive the Drivers of the express priority entitlement of their wage claims, as in *Jevic*, beneficiaries of other priority statutes, such as the United States, can no longer be sure that they are immune from a similar fate.

B. *Jevic*'s Costs

The uncertainty created by *Jevic* imposes at least three types of costs. First, *Jevic* will promote rent seeking: "Contestable priority rules make creditors' returns more variable and harder to predict. The greater variance of their returns may cause creditors

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[20] The statute provides in full: "(a) (1) A claim of the United States Government shall be paid first when (A) a person indebted to the Government is insolvent and (i) the debtor without enough property to pay all debts makes a voluntary assignment of property; (ii) property of the debtor, if absent, is attached; or (iii) an act of bankruptcy is committed; or (B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor." 31 U.S.C. § 3713. It does not apply to a debtor in a bankruptcy case under title 11. *Id.*

to raise their prices or forgo what would otherwise be value-increasing transactions." Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 Va. L. Rev. 1235, 1273 (2013).

To be sure, commercial lenders who can "adjust" to these new conditions can respond by contracting the supply of credit or raising its price. A common critique of uncertain legal rules, and of nonconsensual deviations from rules that were previously thought to be certain, is that they increase the costs of credit. Mark J. Roe & David A. Skeel, Jr., *Assessing the Chrysler Bankruptcy*, 108 Mich. L. Rev. 727 (2010). But the Drivers, the objecting creditors in *Jevic*, are generally recognized to be "non-adjusting" creditors. "Non-adjusting" creditors "do not choose to extend credit to the corporation, and so cannot through pricing or other market mechanisms adjust their rights against the debtor, even if the debtor fully encumbers its assets." Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. Rev. 1189, 1240 (2003). "[E]mployees," for example, "are typically not as able as large institutional creditors to diversify their credit portfolio so as to minimize the impact of their employer filing bankruptcy." *See* Daniel Keating, *The Fruits of Labor*, 35 Ariz. L. Rev. 905, 907 (1993). If a structured dismissal can strip them of the priority Congress gave their claims, they will lose whatever bargaining leverage the Bankruptcy Code gave them.

Put another way, "if the jumped creditors adjust more slowly than the nimble jumping creditors, value transfers occur and such jumps make for winners

and losers." Roe & Tung, 99 Va. L. Rev. at 1241–42. The winners and losers may conflict directly with the priority system created by Congress that has long been central to a reasonably efficient bargaining environment in Chapter 11.

Second, *Jevic* will make it more difficult to resolve Chapter 11 cases through negotiation. Bankruptcy negotiations are most effective when they begin "inside a priority framework." Roe & Tung, 99 Va. L. Rev. at 1271. Here, the lower courts teach that foundational rules on priority can be ignored in "rare" cases that turn out on inspection not to be terribly rare. By creating an underspecified exception to the Bankruptcy Code's priority rules, *Jevic* creates the possibility—or the threat of the possibility—of priority-evading settlements in a wide range of situations. This will increase incidents of dispute and the costs of negotiated resolution because, if the majority opinion below stands, parties simply have less certainty about their priorities relative to one another.

A third cost is to the federal judiciary. It does the bankruptcy courts no favors for an appellate court to hold that subversions of clear statutory priority rules are permitted when the judge deems a case to be "rare." Past practice suggests that parties and professionals will regularly test the boundaries of *Jevic*'s priority deviation, and seek the same or analogous treatment in their own cases.[21] Jacoby &

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[21] The website of one prominent law firm, for example, promotes structured dismissals "as a way to minimize costs and maximize creditor recoveries." *See Taking a Stand Where Few Have Trodden: Structured Dismissal Held Clearly Authorized by the Bankruptcy Code*, Jones Day, Sept./Oct. 2014, http://www.jonesday.com/taking-a-stand-where-few-have-trodden-structured-

Janger, 123 Yale L.J. at 887–89. In other words, supposedly exceptional cases may become the norm. As parties seek these deviations more frequently, bankruptcy judges will, in turn, increasingly be asked to ignore the rule of law.

The Bankruptcy Code's priority rules are a shield protecting bankruptcy judges from having to decide "take-it-or-leave-it" settlements like the one that confronted the Bankruptcy Court here. The challenges associated with sorting amongst these deals can be especially acute in business bankruptcies with fewer resources, less market information, and relatively modest public scrutiny overall. While the Bankruptcy Code relies on judicial discretion with respect to many important decisions, Congress wisely gave judges neither the power—nor the burden—to sort between priority-subverting settlements in the manner *Jevic* would require.

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dismissal-held-clearly-authorized-by-the-bankruptcy-code-10-01-2014/.

CONCLUSION

The settlement agreement and dismissal order in *Jevic* stripped the Drivers of payment and collection rights they are promised by the Bankruptcy Code. This treatment defied the clear language of the Bankruptcy Code, subverting Congress' power to determine the priority of final distributions of a debtor's estate in bankruptcy. The Third Circuit majority, while declaring the case to be "rare," articulated no limiting principles, creating a significant risk that the opinion will distort the resolution of financial distress in the future. This Court should reverse the majority opinion below.

Respectfully submitted.

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APPENDIX

APPENDIX

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